

**Prepared Opening Statement
Dynamic Analysis
September 13, 2006**

When Congress writes the Federal budget each year, we rely on a range of technical rules and conventions – called budget “concepts” – that were designed to give us a stable and consistent playing field for the policy decisions we make.

Because these budget concepts set the rules not only for how we write budgets, but also how we enforce them, I believe that it is critical for this body to engage in a comprehensive review of those rules to ensure that they’re not only accurate, but current, relevant, and truly helpful for our legislative work. While we have done some tweaking here and there over the years, a comprehensive, formal review of our technical rules has not been undertaken in nearly four decades. Clearly, forty year old concepts cannot possibly account for some of the real-world economic precepts that drive our 21st Century economy.

So, last week I introduced legislation establishing a commission of experts to review the technical underpinnings of our budget and accounting practices and report its findings back to Congress. This commission will provide needed oversight and make recommendations on ways to modernize our basic budgetary principles as Congress brings more accountability and transparency to the budget process while dealing with 21st Century issues.

This brings me to the subject of today’s hearing – what’s known as “dynamic” analysis of budget policies – which is one of the most important concepts to be studied under the bill I’ve proposed. Dynamic estimating has been discussed and analyzed – and even attempted, to some degree – since the Reagan administration. And along the way, it has attracted its share of confusion. So let me take a moment to dispel two of the most common misconceptions on the subject.

First, I think everyone understands that dynamic analysis is *not* a means of showing that “tax cuts pay for themselves.” Dynamic analysis *does* show how various pro-growth policies – especially tax policies – affect people’s incentives to work, save, and invest – and thus, affect the economy’s performance. When these incentives are taken into account, they can alter the pace of economic growth, and in turn produce additional tax revenue that might not have been expected without the implemented policies. The impact of our legislative actions must be analyzed to produce a fair, accurate picture of the costs or benefits associated with various tax policies.

For instance, several recent tax measures have had an impact on our overall tax revenues; however, the true impacts of those measures were not “captured” in our original analysis of the proposals. One example that comes to mind is the 1997 tax cuts adopted by Congress. At that time, Congress *cut* taxes by about \$89 billion over five years – and yet tax revenue the next year *increased* from 19.3% of GDP to 20%, and the budget was balanced.

Another example is that over the past two years, we’ve seen double-digit growth in revenue – and declining budget deficits – even though we’ve stuck with the tax relief of 2001 and 2003. These are historical *facts*, demonstrating that *cutting taxes* and *increasing revenue* are not contradictory – *if* you can reduce taxes in ways that enhance incentives for growth.

Dynamic analysis is a way of incorporating these economic effects in our budget estimates.

Second, dynamic analysis does not guarantee perfect accuracy in estimating budget outcomes. But *nothing* could. First, budget estimating always involves making assumptions about what will happen in the *future* – so there will always be some level of uncertainty involved. Add to that the fact that you’re dealing with a \$2.8-trillion budget

in the midst of a highly diverse, \$13-trillion market economy, and the chances of getting absolute precision in budget estimates are slim.

The important benefit of dynamic analysis is that it helps us see more clearly the *real effects of our policy choices*, and the ramifications they can have. It systematically examines how policies affect incentives to work and invest – which directly affect how real people live.

For example, we might find that two different policies with the same budget outcomes actually have very different incentive effects – and therefore different effects on people's lives. Dynamic analysis can “feed back” this information to see how the policy will affect the economy overall. I believe that’s helpful information to have when we’re making important and often expensive policy choices.

Now, budget analysts have already been looking into these incentive effects for some time. But we’ve not pulled together all the pieces for a comprehensive dynamic analysis approach. How to go about doing this is one of the things our witnesses will discuss today.

On a final note – today’s hearing will focus mainly on dynamic *analysis*. And while we often hear the terms “dynamic analysis” and “dynamic scoring” used interchangeably - they are not the same. “Dynamic scoring” deals with a particular *application of* “dynamic analysis.” The analysis is the broader, overarching concept, and again, what we’ll be focusing on today.

To help us in this discussion, we have with us Dr. Douglas J. Holtz-Eakin, former director of our Congressional Budget Office; John W. Diamond, a tax policy expert at Rice University who has worked directly on dynamic analysis for the Treasury Department; and Leonard E. Burman, a senior fellow at the Urban Institute.

Dynamic analysis is a particularly complicated subject, and employs a lot of specialized, technical principles and language. We are fortunate to have witnesses today who are not only very knowledgeable about the subject, but who are also skillful at describing complicated issues to non-economists – such as Members of Congress, other policy makers, and the public.

So again, welcome to all three of you, and thank you for being with us today.

With that, I'll turn to Mr. Neal for any opening statement he may have. Mr. Neal?